IN THE

Supreme Court of the United States

OCTOBER TERM, 1964

No. 644

THE UNITED GAS IMPROVEMENT COMPANY, *Petitioner*

v.

M. H. MARR, SUN OIL COMPANY, CONTINENTAL OIL COMPANY, GENERAL CRUDE OIL COMPANY, TEXAS EASTERN TRANSMISSION CORPORATION, *Respondents.*

No. 693

FEDERAL POWER COMMISSION, *Petitioner*

v.

M. H. MARR, SUN OIL COMPANY, CONTINENTAL OIL COMPANY, GENERAL CRUDE OIL COMPANY, TEXAS EASTERN TRANSMISSION CORPORATION, *Respondents.*

On Writ of Certiorari to the United States Court of Appeals for the Fifth Circuit

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MOTION FOR LEAVE TO FILE BRIEF AND BRIEF OF THE SOUTHERN CALIFORNIA GAS COMPANY, SOUTHERN COUNTIES GAS COMPANY OF CALIFORNIA, AND PACIFIC LIGHTING GAS SUPPLY COMPANY, AS AMICI CURIAE

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The Southern California Gas Company, Southern Counties Gas Company of California and Pacific Lighting Gas Supply Company, respectfully move for leave to file the single accompanying brief *amici curiae*

in these cases. The consents of the petitioners have been obtained. Consents of the respondents have not been obtained. Notwithstanding objection, movants believe their participation herein is in the public interest and that they can make an important and unique contribution to the Court's understanding of the issues here involved.

The movants, as affiliated public utilities, own and operate the largest integrated retail gas distribution system in the United States, serving over 10,000,000 people in Southern California. All of their interstate gas supplies are sold to them for resale and hence are subject to Federal Power Commission certificate and rate jurisdiction.

Movants are vitally interested in the present case because, as distribution companies dependent in large measure upon an interstate supply of natural gas, movants are directly affected by the level of prices charged by producers for deliveries of gas for resale in interstate commerce. While the supply of gas involved in the present case is destined for consumption in the eastern portion of the United States, the precedent value of a decision on the issues at bar would extend to all segments of the industry. Indeed, the decision of the Court of Appeals would severely hamper the Commission's ability to regulate effectively the price charged by producers for gas disposed of in interstate commerce *from any producing area* and could, in consequence, place an undue cost burden upon natural gas distribution companies and the millions of small consumers served by such companies.

Movants, as gas distributors serving the nation's largest and fastest growing gas market, believe that

they can make a definite contribution to the Court's understanding of certain economic factors which must not be overlooked in reviewing this latest attempt to evade regulatory control of natural gas moving in interstate commerce.

Respectfully submitted

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INTEREST OF AMICI CURIAE

The interest of the *Amici Curiae* is set forth in the motion to which this brief is attached.

STATEMENT

The present case arises out of a transaction originally brought before the Federal Power Commission (hereinafter referred to as "the Commission") in 1957. At that time, four producer-applicants—Continental Oil Company (Continental), M. H. Marr (Marr), Sun Oil Company (Sun) and General Crude Oil Company (General Crude)—sought certificate authority under § 7(c) of the Natural Gas Act[1] to make a "conventional" sale of gas from the Rayne Field area of south Louisiana at an initial price of 23.9 cents per Mcf.[2] Texas Eastern Transmission Corporation (Texas Eastern), the purchaser of the gas, simultaneously requested certificate authority to construct the facilities necessary to connect its existing transmission line with the gas to be delivered to it at Rayne Field.[3]

Prior to the issuance of the Commission's decision on such applications, and shortly after the decision of the Third Circuit Court of Appeals rejecting the 22.4 cents-per-Mcf initial price for gas from South Louisiana in the *CATCO* case,[4] the transaction was recast in its present form, i.e. to provide for a sale of leasehold interests by the four producers to Texas Eastern (through a Texas Eastern subsidiary). Accordingly, the Texas Eastern application was reopened for further hearings on the merits of its application to attach

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[1] 15 U.S.C. §§ 717-717w.

[2] The term "Mcf" is used to designate 1000 cubic feet of natural gas.

[3] The applications of Texas Eastern and the producers were consolidated for purposes of hearing and decision at F.P.C. Docket No. G-12446, *et al.*

[4] *Public Service Commission* v. *F.P.C.*, 257 F.2d 717 (3rd Cir. 1958); *aff'd* 360 U.S. 378 (1959).

gas supplies acquired through the lease-sale transaction. The producer-applicants; proceeding on the theory that Commission jurisdiction did not extend to their sale of gas leases to Texas Eastern, withdrew their certificate applications.[5] The Commission in 1959 granted Texas Eastern the requested authority to acquire the Rayne Field reserves. This approval was reversed on appeal, however, the D.C. Circuit Court of Appeals holding that the Commission erred in failing to apply the *CATCO* "hold the line" rule in approving the Texas Eastern acquisition price.[6]

On remand, the Commission conducted further hearings which culminated in the issuance of the decision which is the subject of the instant review proceedings. Specifically, the Commission concluded that the transaction by which Texas Eastern acquired the Rayne Field gas supply was, despite its "lease sale" form, a "sale of natural gas for resale in interstate commerce" within the meaning of that term in § 1(b) of the Natural Gas Act. Accordingly, the Commission required the four producer-sellers to file applications for certificate authority and, in view of the difficulty in de-

[5] Three of the producers withdrew prior to the Commission decision on the revised lease sale (R. 3417, 3423, 3428) and the withdrawal of the fourth, Continental, was authorized as part of the Commission decision (R. 3723).

[6] R. 4038. While the Commission decision had found a unit price of 20.59 cents per Mcf. applicable to the reserves sold under the instant lease sale (R. 3720), the court made no specific unit price finding, noting "the difficulty of comparing an ordinary gas purchase with what is here proposed . . ." (R. 4041). On remand, the Examiner's Decision found a unit price of 24.34 cents per Mcf (R. 4111). The Commission Decision presently on review directed the parties to file new contracts and made no finding as to the unit price established under the lease sale arrangement (R. 4329).

termining the actual unit price for gas under the lease-sale agreement, directed the parties to file a new contract conforming to the principles stated in the Commission order.[7]

The United States Court of Appeals for the Fifth Circuit set aside the Commission's order on the grounds that, under this Court's *Panhandle* decision,[8] the Commission lacks jurisdiction over gas leases and thus could not exert regulatory control over the producers here involved. The decision below limits the scope of Commission inquiry to a determination of whether a certificate should be granted to Texas Eastern in view of the proposed cost of acquisition.

ARGUMENT

I. THE DECISION BELOW IS IN BASIC CONFLICT WITH THE PHILLIPS CASE AND THE REGULATORY SCHEME CONTEMPLATED BY THE NATURAL GAS ACT.

The principal issue to be decided in this case is whether the Commission's jurisdiction over producer sales under the Natural Gas Act extends only to transactions in which gas is sold for resale in interstate commerce according to a conventional form of purchase and sale agreement or whether Commission jurisdiction extends also to an agreement which, although cast in a different form, is nevertheless an instrument

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[7] The Commission order characterized the lease-sale transaction as containing provisions "that would make it difficult if not impossible to subject to regulatory control the price for the sale to an interstate pipeline of this large body of gas . . ." The order further holds that "in order to determine the cost [per Mcf], lengthy hearings would be required and careful consideration would have to be given to factors that should not be involved in a certificate proceeding." R. 4329.

[8] *F.P.C.* v. *Panhandle Eastern Pipe Line Co.*, 337 U.S. 498 (1949).

by which gas is disposed of in interstate commerce for resale for ultimate public consumption. Whereas the court below held that the lease-sale form of the present transaction deprived the Commission of jurisdiction, we contend that, where the essence of the transaction, viewed in its regulatory context, *is indistinguishable* from a conventional gas sale in its impact upon customers of a pipeline, Commission control necessarily applies.

The landmark decision on producer regulation under the Natural Gas Act is, of course, this Court's 1954 *Phillips* decision.[9] There, the scope of Commission jurisdiction was held to include "all wholesales of natural gas in interstate commerce, whether by a pipeline company or not and whether occurring before, during, or after transmission by an interstate pipeline company."[10]

Although the decisions of this Court have placed no precise definition on the term "sale of gas" as used in the Natural Gas Act, it is clear that, under the purposes and objectives of the Natural Gas Act as recognized in *Phillips* and other cases, this term need not and should not be narrowly construed to include only those transactions which qualify as sales of gas in the "property law" sense. The transaction at bar is plainly identical to a conventional gas sale in terms of its regulatory consequences[11] and is therefore subject to the same degree of regulatory control.

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[9] *Phillips Petroleum Co.* v. *Wisconsin,* 347 U.S. 674 (1954).

[10] *Id* at 682.

[11] While the present contracts do not provide for the conventional periodic price escalations, there remains the possibility of an increased unit price since the precise volume of reserves acquired for the fixed, lease-sale price cannot be determined until the reserves are depleted.

In enacting the Natural Gas Act, Congress intended to provide the consumer with "a complete, permanent and effective bond of protection against excessive rates and charges."[12] Given the "comprehensive regulatory scheme" contemplated by the Act, an exemption is not lightly to be implied. Here, the chief difference between the Texas Eastern lease-sale acquisition and the conventional jurisdictional sale is in the timing of the transaction with reference to the production process. Whereas the normal gas sale transfers title to the gas at the surface, the instant lease-sale contract conveys the producer's interest in specified developed gas reserves in their sub-surface location. The form of the transaction, in terms of property law, is different from a sale of a tangible commodity. But the crucial consideration under the Natural Gas Act is that the present lease-sale accomplishes precisely the same end as the ordinary gas sale, i.e. it transfers the gas to Texas Eastern for resale in interstate commerce. Accordingly, the fact that the conveyance occurs before the gas is brought to the surface, and is termed a "lease sale" instead of a sale of gas, should not change the regulatory significance of the transaction.

In *Phillips,* this Court expressly rejected the notion that sales made prior to the completion of the production and gathering process were exempt from jurisdiction[13] and this Court has consistently held that the

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[12] *Atlantic Refining Co.* v. *F.P.C.*, 360 U.S. 378, 388 (1959).

[13] See 347 U.S. at 680, 681, wherein Commission jurisdiction is discussed in the following terms:

> "Petitioners [*Phillips, et al.*] attempt to distinguish the Interstate Case on the grounds that the Interstate Company transported the gas in its pipelines *after completion of gathering and before sale,* and that the Interstate Company was affiliated

relevant test is whether the transaction disposes of gas "in interstate commerce for resale."[14]

The reliance of the court below on this Court's *Panhandle* decision[15] as support for the conclusion that lease sales are within the "production and gathering" exemption[16] is misplaced and illustrates the conflict between the decision below and the jurisdictional principles in *Phillips*. True, the *Panhandle* case holds that "the transfer of undeveloped gas leases is an activity related to the production and gathering of natural gas and beyond the coverage of the Act . . ."[17] But the leases in *Panhandle* were undeveloped leases sold to a non-jurisdictional company operating wholly within the state in which the reserves were located; not, as here, *developed,* proven reserves sold to an *interstate*

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with an interstate pipeline company and therefore subject to the Commission jurisdiction in any event. This Court, however, refused to rely on such refinements and instead based its decision in Interstate on the broader ground that sales in interstate commerce for resale by producers to interstate pipeline companies *do not come within the 'production or gathering' exemption.*" (Footnote omitted, emphasis added.)

[14] See *Interstate Natural Gas Co.* v. *F.P.C.*, 331 U.S. 682, 687 (1947); *F.P.C.* v. *East Ohio Gas Co.*, 338 U.S. 464, 467 (1950). See also *California* v. *Lo-Vaca Gathering Co.*, 33 U.S. L. Week 4159, 4160 (U.S. January 18, 1965), wherein the Court, in ruling on a question of Commission jurisdiction, stated "the fact that a substantial part of the gas will be resold, in our view, invokes federal jurisdiction at the outset over the entire transaction."

[15] *F.P.C.* v. *Panhandle Eastern Pipe Line Co.*, *supra* note 8.

[16] § 1(b) of the Natural Gas Act provides, in pertinent part, as follows:

> "The provisions of this act . . . shall not apply to . . . the production or gathering of natural gas."

[17] 337 U.S. at 515.

pipeline.[18] The *Panhandle* case is simply inapposite since it did not involve a sale of any gas destined for resale in interstate commerce. Moreover, in light of the subsequent *Phillips* holding that the "production or gathering" exemption does not affect the jurisdictional status of sales of gas for resale in interstate commerce, the *Panhandle* ruling on lease sales should not now be broadened; rather, it should be limited to the facts presented in that case.

In sum, the decision below overlooks the congressional purposes, as recognized in *Phillips* and in other cases, to provide a comprehensive scheme of federal regulation of sales of natural gas for resale in interstate commerce and, as we show below, such decision could lead to a breakdown in the effective consumer protection required by the Natural Gas Act.

II. THE DECISION BELOW OPENS AN AVENUE OF ESCAPE FROM COMMISSION JURISDICTION WHICH THREATENS TO UNDERMINE EFFECTIVE REGULATION IN THE PUBLIC INTEREST.

From the point of view of a distributing system dependent, in large measure, on an interstate gas supply, the present case has a significance far beyond the terms of the particular transaction at bar. To exempt an otherwise jurisdictional transaction solely by reason of its lease-sale form is an open invitation for other producers to deliver gas to the interstate market free of regulatory scrutiny.

The natural incentive of producers to avoid Commission rate regulation is a well-known fact. Indeed, the present case is one of a series of similar transactions, now in various stages of litigation, in each of

[18] *Id.* at 500, 501.

which producers seek to commit sizeable blocks of gas reserves to the interstate market without approval of the price to be charged. The *CATCO* companies, for example, *pursuant to a lease-sale agreement*, have conveyed to Tennessee Gas Transmission Company a gas reserve from the Ship Shoal area, offshore Louisiana, estimated at 500 million Mcf[19] and a similar agreement between Pan American Petroleum Company and Tennessee Gas, involving approximately 750 million Mcf from the Bastian Bay field, South Louisiana, was held jurisdictional by the Commission.[20] The U.S. Court of Appeals for the Tenth Circuit recently reversed the Commission's ruling and held that the transfer of leases was beyond Commission control in view of the *Panhandle* decision discussed *supra*.[21] Other similar arrangements have been proposed but withdrawn after adverse Commission or Examiner's decisions on the jurisdictional issue.[22]

The use of the lease-sale device to escape regulatory control over producer prices may not necessarily be limited to new deliveries of gas to the interstate market. If, as the court below has held, lease sales are exempt as part of the production and gathering process, it may well be that supplies already committed to the interstate market will be sold by pro-

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[19] *Continental Oil Co. et al.*, Docket No. RI64-129. The Commission order asserting jurisdiction over the lease-sale was issued October 23, 1964, rehearing denied, December 21, 1964.

[20] *Tennessee Gas Transmission Co.*, 30 F.P.C. 1477 (1963).

[21] *Pan American Petroleum Co.* v. *F.P.C.*, (Nos. 7659, 7751, 10th Cir., December 30, 1964).

[22] See *Tennessee Gas Transmission Co.*, 29 F.P.C. 4 (1963) (reserve volume of 405 million Mcf); *Monterey Gas Transmission Co.*, 29 F.P.C. 929 (1963) (reserve volume of 6 billion Mcf).

ducers—in lease-sale transactions—to pipelines, without regulatory control as to price.

Other types of contractual arrangements to avoid Commission regulation of producer sales have been proposed,[23] and this Court has only recently rejected efforts to segregate, by contract terms, gas sold to interstate pipelines for specific non-jurisdictional uses.[24]

In view of the natural tendency to take advantage of any exemption from Commission regulation and the relative ease with which such exemption could be achieved under the ruling below, there is little doubt that an affirmance of such ruling would allow a substantial, if not preponderant, portion of the nation's gas reserves to be delivered into interstate commerce without regulatory control as to price. Whether the producing states could regulate a transaction which effectively conveys gas for resale to an interstate, Commission-regulated pipeline (such as Texas Eastern) is extremely doubtful.[25] Even if such local jurisdiction could be upheld, there is little likelihood that it would be exerted since the principal beneficiaries of

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[23] *F.P.C.* v. *Transcontinental Gas Pipe Line Corp.*, 365 U.S. 1 (1961); *Southern California Edison Co.*, Docket Nos. CP61-172, *et al.* Order permitting withdrawal of application and terminating proceedings, 29 F.P.C. 25 (1963); *Gulf Pacific Pipeline Co.*, Docket No. CP63-223, (application now in hearings before the Commission.) Each of these cases involve a direct sale by the producers to the end-user of the gas.

[24] *California* v. *Lo-Vaca Gathering Co., supra,* note 14; *F.P.C.* v. *Amerada Petroleum Corp.*, —— U.S. —— (No. 585, decided February 1, 1965).

[25] Cf. *Panhandle Eastern Pipe Line Co.* v. *Michigan Public Service Comm'n.*, 341 U.S. 329 (1941); *Public Utilities Comm'n.* v. *Attleboro Co.*, 273 U.S. 83, 89 (1927); *California* v. *Lo-Vaca Gathering Co., supra* note 14.

any such regulation would be located in other states served by the interstate pipeline. Under such circumstances, the ruling set forth in this Court's *Transcontinental* opinion[26] is clearly applicable. In determining the scope of Commission jurisdiction under the Natural Gas Act, it was there held that

> "[I]t is equally clear that Congress did not desire that an important aspect of this field be left unregula ed. . . . Therefore, when a dispute arises over whether a given transaction is within the scope of federal or state regulatory authority, we are not inclined to approach the problem negatively, thus raising the possibility that a 'no man's land' will be created . . . . That is to say, in a borderline case where congressional authority is not explicit we must ask whether state authority can practicably regulate a given area and, if we find that it cannot, then we are impelled to decide that federal authority governs."[27]

The need for regulatory control over transactions of the kind here in issue is beyond question; under the circumstances present in this case, the only adequate and appropriate means of regulation is Commission control under the Natural Gas Act.

III. THE DECISION WOULD HAVE AN INFLATIONARY IMPACT ON FIELD PRICES OF NATURAL GAS.

As this Court is well aware, development of an effective regulatory program for independent gas producers has created difficult problems for the Commission.[28] The decision below will greatly aggravate those

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[26] *F.P.C.* v. *Transcontinental Gas Pipe Line Corp., supra* note 23.

[27] *Id.* at 19-20.

[28] See *Wisconsin* v. *F.P.C.*, 373 U.S. 294 (1963).

problems, not only by the grant of exemption to a particular form of transaction, but through the resulting increase in gas costs of pipeline suppliers of distribuiton companies, and the rates paid by ultimate consumers of such companies. Southern California Gas Company, Southern Counties Gas Company of California and Pacific Lighting Gas Supply Company (Southern California Companies) are affiliated public utilities, owning and operating the largest integrated natural gas distribution system in the United States. These companies distribute natural gas through approximately 2.8 million meters to a population of about 10 million people in the southern portion of California.

The Southern California Companies' operation is typical of that provided by approximately 200 "straight" natural gas distributors[29] throughout the country. These natural gas distribution companies perform the bulk of the nation's business in buying gas and distributing it through the gas mains which underlie almost every city in the United States.

At the present time, the Southern California Companies' interstate gas purchase costs exceed $187 million a year. The gas, all resold in California, is delivered to them at the California-Arizona border at rates which, while subject to the jurisdiction of the Federal Power Commission, are in large measure dependent upon the rates charged by the producers supplying gas in the field to the pipelines. Accordingly, the Southern California Companies are vitally inter-

[29] Those companies selling only gas as distinguished from combination companies, selling both gas and electricity, such as Pacific Gas & Electric Company. Less than 25% of the nation's gas service is supplied by combination gas and electric companies.

ested in the maintenance of effective producer rate regulation under the Natural Gas Act.[30]

It follows that the decision below is of fundamental importance to the Southern California Companies, as well as other similarly situated gas distributors, since it presents the possibility, if not the probability, that a substantial portion of the present and future sales of gas by producers in interstate commerce will be exempt from regulation. If a significant share of producer sales are uncontrolled as to price, the inevitable effect will be to increase the price paid for gas in the field,[31] and thus ultimately to increase the distributors', as well as the consumers', gas costs. In this manner, the favorable trend in producer rate regulation, achieved primarily through the "hold the line" policy enunciated in the *CATCO* case, would abruptly be reversed.[32]

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[30] An increase of 1 cent per Mcf in the average unit cost of gas supplied to the Southern California Companies would represent an annual cost increase of approximately $7 million.

[31] In each of the lease-sale transactions thus far proposed, the price charged for the gas has been substantially above the Commission's "in-line" price standards developed under the *CATCO* mandate. In the present case, the 24.34-cent price found by the Examiner compares with an "in-line" price of 18.5 cents for South Louisiana.

[32] The "hold the line" policy, originating in this Court's *CATCO* opinion (*Atlantic Refining Co. v. Public Service Comm'n.*, 360 U.S. 378 (1958)) has been implemented by the Commission's Statement of General Policy No. 61-1, 24 FPC 818 (1960) and the certificate conditioning and rate suspension policies adopted therein. In addition, the Commission's "in-line" price policy has been upheld in numerous cases involving reductions in initial prices proposed by producers for sales to pipelines, including those supplying the California market. See, e.g., *California Oil Co.* v. *F.P.C.*, 315 F.2d 652 (10th Cir. 1963); *Shell Oil Co.* v. *F.P.C.*, 334 F.2d 1002 (3rd Cir. 1964). Cf. *F.P.C.* v. *Texaco, Inc.*, 377 U.S. 33 (1964).

Further and more substantial benefits through effective producer rate regulation are anticipated upon the conclusion of the Permian Basin area rate proceeding, wherein the justness and reasonableness of the rates collected for a major portion of the gas ultimately consumed in California is now before the Commission for decision.[33] These significant and long-sought gains in effective regulation of interstate sales of gas, and indeed the whole of the Commission's program of producer regulation, would stand in serious jeopardy if the transaction here in question is declared exempt from Commission jurisdiction.

We do not contend that the present transaction is *per se* contrary to the public interest. We contend that the public interest, as well as the terms of the Natural Gas Act, require that transactions of the type at bar be subjected to the same regulatory scrutiny applicable to any other delivery and sale of gas for resale in interstate commerce.

While the precise level of the adverse impact on the consuming states of the decision below cannot be foreseen, it is beyond question that the economic consequences throughout the United States would be serious and severe. The Natural Gas Act was intended to provide "complete protection" against excessive rates and it would be anomalous, indeed, to hold that the aim of a statute so motivated can be frustrated by a mere change in the form of a transaction disposing of gas for resale in interstate commerce.

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[33] See Presiding Examiner's Initial Decision on Permian Area Rates, issued September 17, 1964, recommending substantial rate reductions and returns on sales made by producers in the Permian Basin. Under present regulatory policy, refunds received by jurisdictional pipelines would be "passed through" to the distributing companies and ultimately to the gas consumer.

CONCLUSION

The Natural Gas Act is clearly intended to provide effective consumer protection through rate regulation and its jurisdictional provisions should not be construed so as to nullify or restrict the Act's principal purpose.

The lower court's decision places controlling weight on the *form* of the transaction here in question and, by holding such transaction exempt from Commission jurisdiction, permits a producer to dispose of gas for resale in interstate commerce without the rate regulation required by the Natural Gas Act. The decision points the way to a circumvention of the rate-making provisions of the Act by producer-suppliers of gas in interstate commerce and thus poses a serious threat to the Commission's scheme of producer rate regulation at a time when that program is finally on the threshold of effective operation.

For these reasons, the Decision of the Court of Appeals should be reversed and vacated.

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